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July 1, 1999

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

VIA HAND DELIVERY

Magalie R. Salas, Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: Notice of Written *Ex Parte* Submission by the Association for Local Telecommunications Services

Re: Notice of *Ex Parte* Presentation by the Association for Local Telecommunications Services

Access Charge Reform	)	**Docket No. 96-262**
	)	
Petition of U S West Communications, Inc. For Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA	)	**Docket No. 98-157**
	)	
SBC Companies For Forbearance from Regulation as a Dominant Carrier for High Capacity Dedicated Transport Services in Specified MSAs	)	**Docket No. 98-227**
	)	
Petition of Bell Atlantic Telephone Companies For Forbearance from Regulation as a Dominant Carriers in Delaware; Maryland; Massachusetts; New Hampshire; New Jersey; New York; Pennsylvania; Rhode Island; Washington, D.C.; Vermont; and Virginia	)	**Docket No. 99-24**

Petition of Ameritech For Forbearance from Dominant Carrier Regulation of its Provision of High Capacity Services in the Chicago LATA	))))	**Docket No. 99-65**

Dear Ms. Salas:

Pursuant to Sections 1.1206(b)(1) and (2) of the Commission's Rules, the Association for Local Telecommunication Services ("ALTS"), by its attorneys, submits this notice in the above-captioned docketed proceeding of an oral *ex parte* presentation made and written *ex parte* materials distributed on June 30, 1999 during a meeting with Linda Kinney of Commissioner Ness's Office. The presentation was made by Cronan O'Connell and Emily Williams of ALTS, Daniel Kelley of HAI Consulting, Inc. and John Heitmann of Kelley Drye & Warren LLP. Copies of the written materials distributed at the meeting are attached hereto.

During the presentation, ALTS addressed issues raised by the Petitions for Forbearance from price regulation filed by a number of incumbent local exchange carriers ("ILECs") in the above-captioned proceedings. ALTS highlighted positions and conclusions presented in the attached handout and in the policy paper "Deregulation of Special Access Services: Timing is Everything" prepared on behalf of ALTS by Mr. Kelley. The discussion focused largely on the following points: ILECs retain market power in the market for special access services; ILECs have not used the pricing flexibility they already have in order to respond to competition with lower rates; ILECs have not complied with the Section 251 unbundling obligations that would provide competitive local exchange carriers the ability to compete with ILEC special access offerings via unbundled network elements; and pricing flexibility could result in predatory pricing and price squeezes that would be harmful to competitors and, ultimately, consumers.

Pursuant to the Commission's rules, ALTS submits an original and two (2) copies of this written *ex parte* notification and attachment for inclusion in the public record of the above-referenced proceeding. Please direct any questions regarding this matter to the undersigned.

Respectfully submitted,

John J. Heitmann

John J. Heitmann

Attachment

cc: Linda Kinney, Legal Advisor, Commissioner Ness
International Transcription Service

Deregulation of Special Access Services -- Timing is Everything

ALTS

June 29, 1999

ILECs Retain Substantial Market Power

- In the provision of special access services
- In the provision of network components needed by CLECs to compete in this market
  - Loops
  - Access to collocation
  - Interoffice transport
- Even within the narrow service and geographic niches where CLEC competition is developing.

If the Commission grants the ILECs' forbearance petitions, this market power could be used to harm both consumers and competition.

- Where competitive alternatives are not available, prices can be raised.
- Where competitive alternatives are available, prices can be reduced in an anti-competitive manner.
- The net effect will be a reduction in consumer welfare because the prospects for competition will be reduced.

The potential for short-run predatory pricing cannot be ruled out:

- Modern economic analysis demonstrates that predatory behavior can be profit maximizing under certain circumstances.

- Multi-market and network businesses allow dominant firms to signal rivals in order to discourage entry.

- The Department of Justice complaint against American Airlines shows that the antitrust authorities understand and disapprove of such predatory pricing behavior.

The Commission has recognized the danger of strategic anti-competitive pricing:

"If the incumbent is able to develop a reputation of aggressively competing via targeted bids with recent entrants by doing so in a handful of markets, it may be able to dissuade potential entrants from entering any of its other markets. Thus, the incumbent may protect its monopoly position in all of its markets by aggressively competing in markets where entry initially occurs."

In the Matter of CC Docket No. 97-158, Southwestern Bell Telephone Company Transmittal No. 2633 Tariff F.C.C. No. 73, Order Concluding Investigation and Denying Application For Review, rel. November 14, 1997.

The phased-in deregulation of the long distance market was successful.

- That experience can be used to inform Commission decisions regarding deregulation of local markets as well.
- AT&T was declared non-dominant in 1995 only after barriers to entry into the interLATA long distance business had been substantially removed.
- Competitors were no longer dependent on AT&T for facilities needed to compete.
- AT&T had surrendered almost 40 percent of market share and <u>all</u> customers had a choice of carriers.

Despite their market power, ILECs have already been given a great deal of regulatory flexibility:

- In 1980, tariffs were allowed to become effective only after a 90-day review period. Extensive cost support was required. Today, in many cases the tariff notice is 15 days or less and minimal cost support is required.

- Major tariff filings were regularly suspended and investigated. Today, tariffs are often allowed to go into effect with minimal dispute. Tariffs are frequently allowed to become effective even if the Commission finds that an investigation is warranted.

ILECs have been given substantial pricing flexibility

- The Commission has allowed significant rate realignment, allegedly made necessary by competition.
  - The pricing cross-over points between various speeds of service, e.g., voice grade and T1 and T1 and DS3 special access services, are dramatically different today than in years past.
  - Transport competition has led to a dramatic realignment of the rate structure.
  - Rates structures include substantial volume and term discounts.
- They have not taken advantage of the flexibility they have been given

Allowing the ILECs to engage in contract pricing, subject to retaining their tariffs, is not an adequate safeguard.

- Current price cap rules provide ILECs with substantial ability to alter terms and conditions in order to engage in discriminatory and predatory practices
- The benefits of new services may be denied to tariff customers

The ALTS Conclusion

- Contract pricing authority requires ubiquitous, or nearly ubiquitous, competition in the geographic area where the authority is being requested.
  - Actual collocation in 90% of the ILEC wire centers in the LATA.
  - Competitive interoffice transport facilities extending to all offices.
  - An efficient and smoothly operating process for provisioning collocation and unbundled network elements at reasonable prices.

Deregulation of Special Access Services: Timing Is Everything

Daniel Kelley
HAI Consulting, Inc.

June 25, 1999

EXECUTIVE SUMMARY

The incumbent local telephone companies ("ILECs") have asked the Federal Communications Commission ("Commission") to forbear from dominant carrier regulation of interstate high capacity special access and dedicated switched access services ("interstate high capacity services") in various market sectors throughout the United States. Forbearance would allow ILECs to engage in single customer contract pricing. These requests for forbearance are premature. High capacity service markets are not competitive. The ILECs have yet to open their networks to provide the efficient and competitively priced network elements required by competitors if a robust and sustainable competitive marketplace is to develop.

Among the principal findings of this paper are the following:

- The ILECs retain substantial market power in the provision of special access services, even within the narrow service and geographic niches where competitive local exchange carrier ("CLEC") competition is developing.

- If the Commission grants the ILECs' forbearance petitions, this market power could be used to harm both consumers and competition.

    - Where competitive alternatives are not available, prices can be raised.

    - Where competitive alternatives are available, prices can be reduced in predatory manner.

    - The net effect will be a reduction in consumer welfare because the prospects for competition will be reduced.

- The potential for short-run predatory pricing should not be ruled out.

    - Modern economic analysis demonstrates that predatory behavior can be profit maximizing under certain circumstances.

    - Multi-market and network businesses allow dominant firms to signal rivals in order to discourage entry.

    - The Department of Justice complaint against American Airlines shows that the antitrust authorities understand and disapprove of such predatory pricing behavior.

- The Commission has recognized the danger of such strategic anticompetitive pricing:

    "If the incumbent is able to develop a reputation of aggressively competing via targeted bids with recent entrants by doing so in a handful of markets, it

may be able to dissuade potential entrants from entering any of its other markets. Thus, the incumbent may protect its monopoly position in all of its markets by aggressively competing in markets where entry initially occurs."[1]

- Allowing the ILECs to engage in contract pricing, subject to retaining their tariffs, is not an adequate safeguard.

  - Current price cap rules provide ILECs with substantial ability to alter terms and conditions in order to engage in discriminatory and predatory practices.

  - The benefits of new services may be denied to tariff customers.

- The conclusion is that contract pricing authority requires ubiquitous, or nearly ubiquitous, competition in the geographic area where the authority is being requested. This requires:

  - An efficient and smoothly operating process for provisioning collocation and unbundled network elements at reasonable prices.

  - Actual collocation in virtually all wire centers in the LATA.

  - Competitive interoffice transport facilities extending to all offices.

- Despite their market power, ILECs have already been given a great deal of regulatory flexibility:

  - In 1980, tariffs were allowed to become effective only after a 90-day review period. Extensive cost support was required. Today, in many cases the tariff notice is 15 days or less and minimal cost support is required.

  - In the 1980's, major tariff filings were regularly suspended and investigated. Today, tariffs are often allowed to go into effect with minimal dispute. Tariffs are frequently allowed to become effective even if the Commission finds that an investigation is warranted.

  - ILEC rate structures for these services are dramatically different today than they were when competitive access provider ("CAP") competition began. The pricing crossover points between various speeds of service, e.g., voice grade and T1 and T1 and DS3 special access services, have changed considerably.

[1] *See,* In the Matter of CC Docket No. 97-158, Southwestern Bell Telephone Company Transmittal No. 2633 Tariff F.C.C. No. 73, Order Concluding Investigation And Denying Application For Review, Released: November 14, 1997.

- The Commission has allowed significant rate realignment, allegedly made necessary by competition.
- Transport competition has led to a dramatic realignment of the rate structure.
- Rate structures include substantial volume and term discounts.

• Regulation has not prevented ILECs from introducing new services. ILECs do, of course, control the speed at which they deploy services.

• The ILECs have not taken full advantage of relaxed regulation for special access services:

  - Prices for these services remain at the generous caps.
  - Prices are high relative to forward-looking costs even though the Commission would be unlikely to deny a generally available rate reduction.

• This is not to say that there are no deregulatory steps that could be taken today.

  - The Commission may consider reducing tariff notice and cost support requirements for special access services on the condition that the service is generally available and no rate element is priced below the corresponding total element long-run incremental cost ("TELRIC") price.

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